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SUBJECT: RUSSIA-UKRAINE: "COMPLICATED" ENERGY TALKS

Classified By: Pol M/C Alice G. Wells for reasons 1.4(b) and (d)

11. (C) Summary: In a May 4 meeting, MFA Second CIS Director Viktor Sorokin repeatedly described Tymoshenko's April 29 energy talks with Putin as "complicated." In one-on-one, small group, and the plenary meeting of the Intergovernmental Committee on Economic Cooperation, it was decided that Gazprom would not fine Ukraine's Naftohaz for taking less gas than it had contracted for, while Gazprom and Naftohaz would negotiate new gas volumes for 2009. Like Sorokin, Gazprom's Foreign Relations speaker Ivan Zolotov said Russia was concerned about Ukraine's ability to pay for the 20 billion cubic meter (bcm) gas it planned to purchase for winter storage. Russia rejected Ukraine's request to use the possible USD 5 billion loan to pay for the gas, while Russia's transit fee payments were insignificant by comparison, and Gazprom lacked the funds to prepay them. Sorokin said that Tymoshenko had no concrete proposals on how Russia could participate in Ukraine's pipeline modernization. The Odessa-Brody pipeline and nuclear cooperation were also discussed, while other topics included aircraft, space, and road transportation, and Russia's WTO accession bid. Sorokin described Putin's tone in the final press conference as "critical," while analysts called Tymoshenko's visit "unnecessary" in light of the lack of results. End Summary.

"Complicated" hydrocarbon talks

12. (C) MFA Second CIS Director Viktor Sorokin told us May 4 that Ukraine Prime Minister Tymoshenko's April 29 talks with Prime Minister Putin on energy and in the Intergovernmental Committee on Economic Cooperation were "complicated." Sorokin said the two sides reached "no concrete agreements or contracts related to gas." However, a "political decision" was made that Gazprom would not fine Ukraine's Naftohaz for taking less gas than it had contracted for, while Gazprom and Naftohaz would negotiate new gas purchase volumes for 2009. Gazprom's Director of Foreign Relations, Ivan Zolotov, confirmed the fine could have been USD 2 billion, as Naftohaz had taken less than 50% of the gas for which it had contracted. According to Zolotov, the spirit of negotiations between Gazprom and Naftohaz on new volumes was "calm," as both sides knew each other well.

13. (C) Noting that DPM and Finance Minister Kudrin, DPM Shuvalov, and DPM Sechin all participated in the talks, Sorokin said Russia sought inter-governmental "guarantees" that Ukraine would pay for the 20 bcm winter gas it intended to purchase this summer. While Russian transit fee payments were negligible by comparison with Ukraine's gas bill, Gazprom did not have the means to pay transit fees several years in advance. According to Zolotov, transit pre-payment on the part of Gazprom was "not really an option," because

"the financial risks were too high." Sorokin said that Ukraine had alternatively suggested using the USD 5 billion loan requested from Russia to pay for its winter gas purchases, but again negotiations were "complicated." The IMF would not allow Ukraine to do the same with its loans, as a precondition for using IMF monies to that effect would likely be the doubling of domestic gas prices, which was impossible in the pre-election period. Sorokin said no agreement was reached yet on the loan, with Russia waiting for the IMF to finalize the payment of its second loan tranche to Ukraine in its May 13 Board of Governors meeting, but Russia would carefully consider Ukraine's proposals.

14. (C) Regarding Tymoshenko's comments to the press that Ukraine had "invited" Gazprom to participate in the modernization of Ukraine's gas infrastructure, Sorokin said the issue was "more political than economic." He said neither Putin and Tymoshenko nor Gazprom head Alexey Miller and Naftohaz head Oleh Dubyina had substantively discussed the issue. Sorokin noted that while everyone agreed that Ukraine's gas infrastructure needed modernization, it was too early to discuss Russia's contribution, given the lack of concrete details in the plan and the plummeting demand for gas both in Europe and in Ukraine. Zolotov explained that Gazprom would necessarily have to be involved in the modernization of Ukraine's infrastructure, since Ukraine's system was part of the former Soviet Union's Gazprom-run system.

15. (C) Sorokin said Putin's call to consider a consortium approach to the modernization of Ukraine's gas infrastructure

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was not discussed, but still on the table. While repeating Russia did not seek ownership over Ukraine's pipeline system, Sorokin complained that Ukraine wanted others to pay for modernizing its infrastructure without including them in the management, causing the consortium idea to remain "frozen."

16. (C) Sorokin told us no agreement was reached on Ukraine's interest in reversing flows along the Odessa-Brody pipeline. Ukraine's plans could lead to oil supply problems, as Russia might then need to find alternative routes to ship oil to Europe.

Other topics

17. (C) Sorokin said a draft contract on long-term nuclear energy cooperation between Russia and Ukraine was to be signed by mid-July. Although the Ukrainian competition was intense, Russia had won the tender for construction of two units at the Khmelnytsky nuclear power plant due to its expertise with Soviet-era technology. Russia supported Ukraine's desire to join the international fuel bank at Angarsk, but Kazakhstan currently opposed Ukraine's participation. Sorokin expressed surprise at Nazerbayev's actions, but speculated that Kazakh concerns would be resolved in the course of bilateral consultations.

18. (C) As an example of positive Russia-Ukraine cooperation, Sorokin cited the joint development of the Antonov AN-47 and said the AN-70 military transport project was agreed for launch. Given the stiff competition on the world market by companies such as Boeing or Airbus, Sorokin said Russia and Ukraine needed to "unite" their efforts in order to compete globally, noting Ukrainian delays in taking the necessary steps in privatizing its aircraft industry. Sorokin praised the large number of joint space projects between Russia and Ukraine, highlighting the agreements on cooperation in the GLOSSNASS satellite navigation project and IPR protection in Ukraine's cooperation with Brazil in the bi-national Alcantara Cyclone Space (ACS) company. Other transportation issues touched upon included construction of the Moscow-Kyiv and Moscow-Simferopol highways.

¶9. (C) Sorokin said Ukrainian arms transfers to Georgia were not discussed in the meetings, only raised in the press conference. Still, Russia repeatedly addressed the issue with Ukraine, which denied it was making any transfers outside of a bilateral mil-mil cooperation agreement covering defensive weapons. Russia, however, accused Ukraine of transferring offensive weaponry to Georgia, which was "dangerous."

Atmospherics

¶10. (C) Sorokin told us that Tymoshenko met with Putin in a one-on-one meeting followed by a small group session, and then co-chaired the Intergovernmental Committee Meetings on Economic Cooperation, which Russia had postponed from the earlier date of April 8 due out of protest against the EU-Ukraine agreement on gas pipeline modernization. Reporting on his impressions from the small group and Committee talks he had participated in, Sorokin described the atmospherics as "well-meaning and professional," but said he would "not comment on" Tymoshenko's "self-assurance" when she outlined her view of the long-term development of Russia-Ukraine relations. Despite the positive examples of cooperation between the countries such as on space, Sorokin described Putin's tone in the press conference as "critical" in view of the declining bilateral trade.

Analysts: "Unnecessary visit"

¶11. (SBU) Picking up on the "inconclusive" results of the meetings and failure to close the gap on gas issues, some analysts like Svetlana Samoylova on politcom.ru called Tymoshenko's visit "unnecessary." Andrey Kolesnikov in Kommersant noted the strained atmospherics as a result of the lack of agreement, with the Prime Ministers sitting at a distance from one another during the final press conference and avoiding looking at each other. Tymoshenko's offer to assist Russia's WTO bid met with laughter from the

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journalists, who considered the gesture to be of symbolic value. Nezavissimaya Gazeta similarly described the two Prime Ministers as "tired of each other."

Comment

¶12. (C) Putin gave Tymoshenko what she primarily came for, which is the waived fines and negotiations on lower gas volumes Naftohaz will buy from Gazprom this year. However, he provided little assistance in improving her pre-election campaign image as a skilled negotiator with Russia.
BEYRLE